

December 31, 2001

The Honorable Wayne K. Curry, County Executive
The Honorable Peter A. Shapiro, Chair, County Council

In accordance with Subtitle 10, Division 1A of the County Code, the Spending Affordability Committee has reviewed the preliminary projections of the County's General Fund revenue (FY2001 to Projected FY2003) along with the General Fund balance and makes the following preliminary revenue recommendations for FY2003: (Nearest Million \$)

	FY2000	FY2001	FY2002	FY2003
	<u>Actual</u>	<u>Actual</u>	<u>Preliminary</u>	<u>Preliminary</u>
			<u>Estimate</u>	<u>Projection</u>
TAXES:				
Property	409.5	414.8	427.0	438.0
Income	292.3	319.2	327.3	343.2
Transfer/Recordation	65.7	74.2	74.2	74.2
Energy	43.3	43.5	43.7	43.7
Other Local Taxes	18.0	17.3	17.0	17.9
State-Shared	22.9	23.7	23.5	23.6
Subtotal Taxes	851.6	892.8	912.7	940.6
Licenses and Permits	14.6	14.3	15.0	15.6
Use of Money and Property	21.3	23.4	12.1	15.6
Charges for Services	19.5	18.3	18.9	19.4
Intergovernmental	23.5	34.0	33.0	33.2
Miscellaneous	2.2	3.0	3.3	3.5
Other Financing Sources	12.8	11.0	11.0	1.0
Subtotal Other Sources	93.8	104.0	93.3	88.3
SUBTOTAL COUNTY SOURCES	945.4	996.8	1,006.0	1,028.9
SUBTOTAL COUNTY SOURCES W/O USE OF FUND BALANCE	936.4	986.8	996.0	1,028.9
OUTSIDE AID				
Board of Education	456.8	486.3	534.4	581.4
Community College	37.4	41.5	43.8	45.3
Library	6.1	5.8	6.6	6.2
SUBTOTAL OUTSIDE	500.3	533.7	584.8	632.9
GRAND TOTAL	1,445.8	1,530.5	1,590.8	1,661.8

(Note: Figures may not add due to rounding.)

REVENUE ASSUMPTIONS

Property Tax

In FY2003, County Real Property Tax rate will remain unchanged at \$0.96/\$100 assessed value. The Homestead Property Tax credit will be adjusted to 103% from 104%, since the Consumer Price Index increased by 3.2% for the twelve-month period ending June 2001. Real property assessable base is expected to experience a relatively strong growth in FY2002 and FY2003 thanks to new residential constructions and higher reassessed values, according to the State Department of Assessment and Taxation (SDAT). Latest SDAT estimates indicate that real property base in the County increased by over 3% in FY2002. The growth trend is likely to continue as market demands for residential units remain high in this region and housing prices keep increasing. Real property tax revenue is projected to grow by 3.1% in FY2002 and 3% in FY2003.

County Personal Property Tax rate will remain unchanged at \$2.40/\$100 assessed value. Personal property tax revenue is projected to grow by 2.2% in FY02 and by 0.5% in FY2003. The estimated weaker performance is attributed to the impacts of the September 11th attacks and the economic recession on businesses, and also the phased-in exemptions of utility property assessment by the State.

Income Tax

In FY2003, the County's Income Tax revenue is projected to grow by 4.8%, of which 2.5% is attributed to growth in individual income tax receipts and 2.3% will come from an increase in the State disparity grant. In FY2002, income tax revenue is estimated to increase by 2.5%, which includes 1.9% of growth in individual income tax receipts.

During an economic recession when uncertainties are also high due to the September 11th terrorist attacks, County income tax revenue is being affected by slower job growth, higher unemployment, and lower stock prices. Capital gains are expected to suffer a significant drop in FY2002 and FY2003. Wage-related income tax is expected to grow at a slow pace in FY2002 and then pick up slightly in FY2003, assuming that the economy will start to show signs of recovery in FY2003. In September, the County's year-to-year employment growth dropped to 0.7%, two percentage points off the level of the same period last year. Meanwhile, unemployment jumped to 4.4% in September and 4.8% in October with additional layoffs in a weakening economy.

The County is expected to receive \$14.7 million from the Income Tax Disparity Grant in FY2003, because the County fell below 75% of the State's average per capita income tax in calendar year 2000. In FY2002 the County will get \$9.6 million from the State Income Tax Disparity Grant. The increase in grant is partially attributed to higher total disparity grants for distribution, because in calendar year 2000, total net local tax revenues in Maryland increased by 8.7% from 1999. Also, the State changed its population data sources used in the formula this year. As a result, a higher estimate of the County's population is used, which would bring down the per capita income of the County.

Transfer and Recordation Tax

Transfer and Recordation Tax revenues are projected to be flat in both FY2002 and FY2003. During the first five months of FY2002, Transfer and Recordation Tax revenues increased by 8% from the same period of last fiscal year, thanks to lower mortgage rates and high demands in the housing market. However, home sales appear to have lost part of the momentum since the September 11th attacks, dropping from a double-digit year-to-year growth in the summer to only 3% of growth in November. It is possible that home sales will continue to moderate given the uncertainties on the economy until signs of economic recovery emerge. The Transfer tax rate and the Recordation tax rate for FY 2003 will remain unchanged at 1.4% and 0.44% respectively. Among the County's key revenue sources, transfer and recordation tax revenue remains the most volatile.

Energy Tax

The Energy Tax rate will remain at its current level of 7.5%. Energy tax revenue is expected to keep its slow growth pattern in FY2002 and be flat in FY2003.

Other Local Taxes

Due to the negative impact of the September 11th incident, Admissions and Amusement Taxes are expected to lose potential growth from the expansion of Six Flags in FY2002 and see a 0% growth instead. This revenue source is expected to grow by 4% in FY2003, assuming that the economy will start to recover by then.

Interest Income

Interest income is projected to suffer a major reduction in FY2002 after the Federal Reserve cut the interest rates 11 times to a 40 year low. In FY2002, interest income is expected to generate \$10.2 million - roughly half of the level budgeted in FY2002. In FY2003, it is expected to recover part of the loss, assuming that modest interest rate adjustments will occur during FY2003. Interest income is a large part of Other Sources of revenue.

State-Shared Taxes

The State's estimation indicates that Highway User Revenue is likely to be almost flat in FY2003. Highway user revenue is the largest portion of State-shared taxes.

Board of Education Aid

Board of Education Aid growth is expected to be 8.8% in FY2003. Current Expense Aid is expected to increase based on an assumed 2-3% growth in the foundation amount, continued erosion in County wealth per pupil relative to the statewide average, and an anticipated growth in student enrollment at approximately 2%. No new or enhanced revenue sources are assumed in

FY2003. The Board of Education anticipates the receipt of \$17 million in outside grant aid above levels budgeted in FY2002. The Committee has not assumed any new revenues in FY2003 based on implementing the recommendations of the Thornton Commission.

Community College

Community college revenue is projected to grow by 3.4% in FY2003. State Aid for all colleges will increase in FY2002 due largely to growth in the level of State Aid per FTE for State four-year universities (State aid to community colleges is pegged at 25% of that FTE aid level). A modest decline in community college enrollment statewide is projected. State aid to the County's community college assumes that enrollment in this County, as a percent of total State community college enrollment, remains at 12.5%.

Library Aid

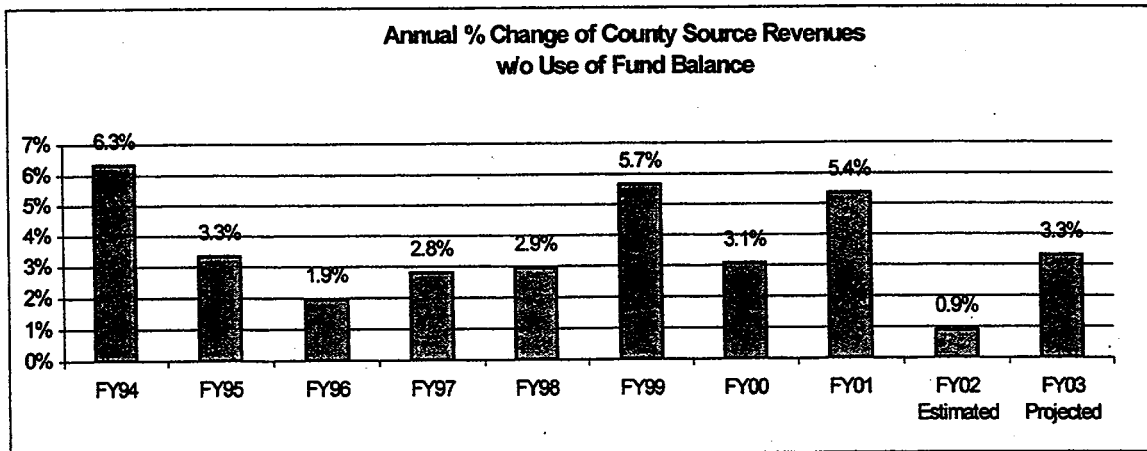
Library revenue is projected to decrease by 5.9% in FY2003. No major increase in State aid is expected. Miscellaneous aid is expected to decline by \$500,000, since use of fund balance is not continued in FY2003.

Revenue and Financial Condition

Latest reports from the Office of Finance show that actual General Fund revenues of the County in FY2001 reached \$1,530.5 million, \$3.4 million higher than the number shown in the Committee's October 1st letter. The difference is attributed to year-end adjustments as well as better-than-predicted income tax revenues in FY2001.

In FY2002, the County's total General Fund revenue sources are projected to reach \$1,590.8 million. The FY2002 revenue estimate is \$8.7 million lower than budgeted due to anticipated decreases in interest income, hotel/motel taxes, and other revenues as a result of the September 11th attacks and the economic recession. County source revenue without use of Fund Balance is estimated to grow by 0.9% in FY2002.

In FY2003, County General Fund revenues are projected to be \$1,661.8 million. County source revenue without use of Fund Balance is estimated to increase by 3.3%. Revenue growth in FY2002 and FY2003 is expected to be relatively low because of the nationwide economic recession and negative impacts of the September 11th attacks. Interest income, income tax, and other revenue sources in general, are likely to see a weak performance in FY2002. Whether these revenue sources could perform much better in FY2003 largely depends on how soon the economy could recover. Given such a situation, the Committee recommends maintaining a conservative fiscal policy and maintaining adequate financial reserves as a hedge against the impact of further economic downturn.



(Note: the FY01 annual percentage growth includes 1.2% of one-time revenue growth)

Expenditures

The Committee recommends an overall spending ceiling of \$1.662 billion, or an increase of \$62.4 million above the FY2002 budget. The following are spending ceilings as defined by Sec. 10-112.21 of the County Code:

Board of Education: \$1,058.6 million (growth of \$56.4 million, or 5.6%). Most of this growth is from non-local funds (\$47.0 million); the remaining growth is from local County revenue sources (\$9.4 million);

Debt Service: \$70.1 million (growth of \$2.8 million, or 4.2%). All of this growth would come from local County revenues.

All Other: \$533.1 million (growth of \$3.2 million, or 0.6%). All of this growth would come from local County revenues.

DISCUSSION ITEMS

Public Safety & Health Expenditure

In FY2002, expenditures on public safety, public works, and health are expected to increase due to one-time costs related to the September 11th terrorist attacks, the September 24th tornado strike in the County and Anthrax incidents. Overtime expenditure is projected to increase in police, fire, public works and other public safety departments. Additional expenses are expected on security personnel and related technologies due to strengthened safety measures. In addition, demands may increase for welfare and other health and social service expenditures from the County as the unemployment rate increases. We have not assumed any recovery for such expenditures from the State or the Federal government.

Board of Education

The Board of Education's budget would comprise 63.7% of the ceiling amount of \$1.662 billion in FY2003 recommended in this report. This represents a 1.0% increase from the level of 62.7% contained in the County's FY2002 Adopted Budget. The major State formula-driven aid categories for public education are structured to ensure aid increases in future years. Increased enrollments from year to year also result in increased aid from both the State, through the Current Expense Aid formula and from the County, through the State's Maintenance of Effort requirement. The decline in wealth per pupil relative to the Statewide average also results in funding increases under current expense aid, since the State contribution is inversely related to wealth. As a result, funding for the Board of Education will continue to grow, independent of the County's overall financial outlook.

Indeed, based on the FY2002 Adopted Budget of \$1,599.4 million, of the \$62.4 million revenue increase projected for FY2003 above the FY2002 Budget, \$47.0 million, or 75.3% represents outside aid that must go to the Board of Education. Additionally, the County must provide an estimated \$9.4 million of the increase to its own source revenues to the Board to guarantee receipt of the increase in State aid. Since County source revenues are only increasing by \$14.5 million over FY2002 budgeted levels, this greatly diminishes any flexibility the County has to fund other County services during times of economic slowdown.

There are two other facts worth noting. First, the County is operating an ambitious capital program to open 26 new or newly reopened schools – 13 of which are required under the terms of a Memorandum of Understanding between the County Government, the Board of Education, and the NAACP. The County is largely utilizing bond proceeds to construct these schools. In recent years, the debt service to pay off these bonds has increased steadily. The County budgeted \$23.4 million in FY2002 for this purpose. These funds are budgeted in the County budget under debt service and are not shown as part of the expenditure budget for the Board of Education.

Second, in FY2002, the County declared \$10 million in fund balance and provided those funds to the Board of Education to pay for one-time expenditures associated with computer purchases and the startup costs for new schools. This was the second consecutive year the County took this action. In the FY2003 preliminary projection, the County has replaced the \$10 million in one-time use of fund balance with \$10 million in revenue from continuing sources before the \$9.4 million Maintenance of Effort funding increase was included. The budget as recommended, therefore, assumes no use of fund balance. The budget projection also assumes limited growth in expenditures for all other functions of County government.

RECOMMENDATIONS

The Committee recognizes that the County's revenue growth is expected to be slow in FY2002 and FY2003 due to the economic recession. Moreover, the September 11th attacks have increased uncertainties on revenues and expenditures. Despite this, the County needs to maintain its key services and its commitment to education. As a result, the Committee makes the following recommendations:

- ◆ The County should maintain a conservative fiscal policy and maintain adequate financial reserves.
- ◆ The Committee recommends a budget ceiling of \$1,058.6 million for Board of Education in FY2003. This assumes a \$47 million increase in outside aid and that the County continues to provide maintenance of effort support for the school system. There is no assumption of additional funds based on recommendations of the Thornton Commission.
- ◆ We do not recommend declaring fund balance in the FY2003 budget; but in light of the revenue constraints and on-going public safety and health efforts since September 11th, we acknowledge that the County may have to use some of those funds to support one-time expenditures. In such a case, use of fund balance should be restricted to one-time expenditures.
- ◆ We recommend that the County start its multi-year fiscal planning practice based on historical data, which could help the County plan ahead. While there are significant year-to-year variations in revenues, long-term averages have been relatively stable. The County's 10-year average annual growth of county source revenues in the past decade has been 3.4%, including use of Fund Balance.

SUMMARY

The Committee wishes to thank both the Executive and Legislative Branches of government for the opportunity to review the County's revenue forecast. We have had several official meetings with County staff. The Committee utilized the County's financial reports, State of Maryland tax data and information from budget offices of other counties. We believe that we have performed due diligence in reviewing revenue estimates for FY2002 and FY2003 and believe them to be reasonable.